INDUSTRIAL RESTRUCTURING AND PRIVATISATION IN CENTRAL AND EASTERN EUROPE: IMPACT ON ECONOMIC GROWTH AND EMPLOYMENT

Report on a joint meeting of management and trade union experts held under the OECD Labour/Management Programme

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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(Paris, 16-17 September 1993)

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Foreword

Under the OECD Labour/Management Programme for 1993, a joint meeting of management and trade union experts on "Industrial Restructuring and Privatisation in Central and Eastern Europe: Impact on Economic Growth and Employment" was held in Paris on 16-17 September 1993. The meeting was prepared in collaboration with the Business and Industry Advisory Committee to the OECD (BIAC) and the Trade Union Advisory Committee to the OECD (TUAC).

Below is an overall report of the discussions of the meeting of experts, prepared by Mrs. Françoise Lemoine who was designated as General Rapporteur for this activity.

A list of the participants in the meeting is given in the Annex.

THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT ARE THE RESPONSIBILITY OF THE AUTHOR AND DO NOT NECESSARILY REPRESENT THOSE OF THE OECD.
I. INTRODUCTION

The purpose was to assess the impact of ongoing industrial restructuring in Central and Eastern Europe and to ascertain the role of privatisation; to determine policies that could help enterprises adapt more quickly to new competitive conditions, so as to curb industrial recession and rising unemployment; and to identify economic strategies that could minimise the cost of transition and make it acceptable to society.

Despite the vast agenda, headway was made on a large number of issues. The calibre of the discussions owed much to the active participation of management and trade union experts from Partners in Transition (PIT) countries. At a time when Western Europe too is grappling with industrial restructuring and joblessness, their dialogue enabled OECD and PIT experts to put the adjustments in an overall international perspective and to gauge the extent of economic and social interdependence.

Discussions revolved around four major topics: (i) privatisation, restructuring and industrial policies; (ii) competitiveness and national and regional markets; (iii) active employment policies; (iv) co-operation with Western countries in respect of structural policies.

II. PRIORITIES OF NATIONAL RESTRUCTURING POLICIES: INDUSTRIAL POLICIES AND THE PRIVATISATION PROCESS

The discussion revealed the experts' fairly broad consensus on the links between the privatisation and inevitable restructuring of large industrial enterprises, and on the conditions and policies needed for successful restructuring.

i. The Central and Eastern Europe countries (CEECs) have adopted different solutions to address the almost immediate problems of privatising large enterprises. PIT experts outlined each country's procedures and individual circumstances, with experts from the Czech Republic reporting that mass privatisation was making rapid progress, although its effect on industrial restructuring was not yet clear, while those from other countries emphasised the many obstacles hampering privatisation: a shortage of domestic capital, a lack of procedural transparency and democratic control, the ill-defined scope of privatisation, and the risk that capital will be undervalued.

Today, the privatisation and restructuring of enterprises are viewed as two separate processes; a number of experts stressed that privatisation is no cure-all, and that it raises productivity only if accompanied by specific restructuring measures. For that reason, there were warnings against hasty moves that could have a detrimental effect on both the privatisation and restructuring of a firm's activities.
As for the very concept of privatisation and its role in the transition to a market economy, the prevailing opinion was that privatisation, far from constituting an end in itself, should above all be considered a means of establishing an efficient market economy and a viable private sector, and that the objective remains growth and job creation. A divergent view was expressed by one expert, who insisted that private enterprise was the bedrock of a market economy and that privatisation was essential if businesses were to function smoothly; that the market economy, private enterprise and democracy were inextricably linked. Similar differences of opinion emerged from contrasting assessments of the results of privatisation in the former East Germany.

ii. Direct foreign investment contributes to this parallel privatisation and restructuring, largely because domestic capital is in short supply. Notwithstanding, a number of participants stressed the need to limit FDI, inasmuch as it offers no real solution to the economic crisis, since restructuring after acquisition by a foreign firm very frequently gives rise to massive layoffs. Furthermore, there is a danger that foreign investors will try to build local market monopolies; here the experts agreed it was essential to establish a regulatory framework that would guarantee a competitive environment, and one that would be as transparent as possible.

iii. The restructuring of enterprises -- public or private -- is still the most fundamental, pressing problem of economies in transition. The plunging industrial output of all Central and Eastern European countries between 1989 and 1992 illustrates the problems firms had in adapting to the new supply and demand conditions of domestic and foreign markets, and thereby shows how badly restructuring is needed. Even so, many enterprises have postponed massive layoffs, their workforce reductions are yet to come. As a result, much of the multifaceted corporate restructuring process (which comprises legal, financial, and technical aspects) remains unfinished, and the quest for productivity gains will inevitably lead to job cuts. A number of speakers pointed out the particularly great need to restructure sectors such as defence industries in Slovakia and mining, stressing the seriousness of the economic and social problems involved. A case study presented by the OECD Secretariat focused on how corporate restructuring programmes could improve profits and wages and, at the same time, slash jobs. But the study also showed that solutions (such as severance pay and outplacement) could be found for employment problems, and that they could be extremely effective.

iv. Most speakers felt that industrial restructuring called for appropriate State action and an efficient public sector, and they agreed on the need for a concerted industrial policy. The OECD Secretariat pointed out that there was a consensus that industrial policies could be useful if they consisted of horizontal-type measures that influenced industry indirectly, and of incentives to competition. Nevertheless, it is difficult even to determine exactly what industrial policy should cover, just when the distinctions between industry and services are blurring and the expansion and modernisation of the service sector are destined to play a leading role in the economic restructuring of PIT countries. State intervention was seen as crucial to the development of both infrastructure, such as transport and telecommunications, and human resources, as concerns education, vocational training and health care. Trade union representatives stressed the need for employment policies, whereas management speakers warned against direct State intervention in the form of subsidies.
But as one Hungarian expert put it, in a context dominated by collapsing industrial output and inadequate funding and tax revenues, industrial policy can scarcely be anything more than a blueprint for crisis management.

v. Among the other success factors for restructuring programmes, overriding importance was attributed to top-level commitment to restructuring, and to the competence of the various parties involved -- executives and managers, owners, and government agencies. Many experts cited the handicap represented by the current shortage of managerial ability in many of the areas crucial to a modern market economy, such as finance, marketing and budgetary control. In this respect, many PIT experts underscored the essential role of transfers of knowledge and know-how from OECD countries, at all levels, and mentioned various ways in which this could be done: by setting up management teams in enterprises, undertaking case studies and creating schools of business administration. One expert pointed out that in order to do any good, transfers of knowledge had to combine the abilities of both sides -- the OECD’s technical expertise and the PITs’ knowledge of local environments.

vi. Most people acknowledge the importance of democratic control and of the involvement and solidarity of all parties concerned whenever a restructuring programme is implemented. Several experts stated that trilateral negotiations, bringing together management, trade unions and government, were vital to economic and social democracy and, more generally, to political stability. But the advantages of trilateralism were hotly contested by one management expert, who contended that experience has shown that it can lead to the development of corporatism and the dilution of responsibility and that, if taken to extremes, it was in no way a guarantee of democratic control.

III. DETERMINANTS OF COMPETITIVENESS AND POTENTIAL MARKETS

The purpose of the restructuring currently underway is to spur a resumption of growth thanks to the gradual rise of competitive industries, in international as well as domestic markets. The only question is whether these markets have enough demand to drive an upswing in Central and Eastern European output. Here the discussion focused on three issues:

i. The comparative advantages of Central and Eastern European industries

Since the early days of transition, the rapid growth in PIT exports to the OECD countries had been based largely on the price advantage of Eastern European products and, more specifically, on cheap labour. But there are two questions as to whether competitiveness of this sort can be sustained: first, by competing in industries with low labour costs, the PIT countries would face direct competition from other Europeans still farther to the east (such as Ukraine), where wages are a great deal lower even than in the CEECs; second, as one speaker pointed out, the reason why PIT production costs are so low is that they are still partially distorted by a price structure that remains far from perfect, especially in that it incorporates only a portion of the true cost of infrastructure and energy.

ii. The new prospects offered by various markets

Local and regional markets provide natural outlets which are targeted in particular by foreign firms when they invest in the modernisation and expansion of local capacity to produce consumer goods (e.g. automobiles), but low purchasing power currently limits the market’s capacity to absorb these goods;
in the future, this capacity will hinge largely on price policies. A recent example of price hikes on joint-venture-made cars was cited as an indication that the prospects for sales in these markets had their limits.

For the short term, it seems fairly improbable that the industries of Central and Eastern Europe could exploit geographical proximity and their old network of economic ties by resuming substantial exports to the former Soviet Union. Trade with the CIS countries is suffering from the lack of any organisational framework; the bulk of it is handled through either third-country trading firms or dubious (Mafia) channels outside the mainstream of international trade. Co-operation between partners in Western and Eastern Europe might be able to help restore normal terms of trade with these countries.

Western Europe has been the target of PIT trade redeployment since 1989, but the area’s current recession is preventing it from being the engine of export-driven Eastern European growth. Trade will undoubtedly expand less rapidly than in the past. Nevertheless, in one expert’s opinion, industrial restructuring in Eastern Europe will inexorably force restructuring in the West.

The issue of finding markets for the PIT industries currently being restructured ultimately led to the conclusion that corporate sales strategies had to take account of the globalisation of markets.

### iii. The engines of growth

If international conditions for export-led growth will not exist in the years ahead, then other solutions must be found to drive economic growth in Central and Eastern Europe. One expert held that an essential issue in financing growth was the profit redistribution model, i.e. the way in which investors, and particularly foreign investors, will decide to apportion productivity gains among wage increases, local investment and profit repatriation.

The OECD Secretariat raised the possibility of spurring a resumption of industrial growth with an investment policy based on increased tapping of international financing sources (e.g. World Bank and EBRD).

### IV. ACTIVE EMPLOYMENT POLICIES

The OECD Secretariat’s introductory report highlighted the conditions that shape employment policies, which in most PIT countries are caught in a squeeze between mounting joblessness and shrinking budgets; they are hardly in a position to choose freely between aiding job creation and compensating the unemployed.

i. Rising unemployment has caused the cost of basic "passive" measures (e.g. unemployment compensation) to rise more rapidly than the corresponding sources of funds, which were set up quickly at the start of the transition. But these compensation systems are less generous than their Western European counterparts, and there is scant room to make them any more restrictive. As a result, the resources available for active policies, which foster job creation and enhance the labour market, are limited. Already, rising long-term unemployment is demonstrating that compensation schemes cover too short a
period and may leave more and more people with no safety net and increasingly hard to bring back to the job market. In some countries, the number of people receiving unemployment compensation is already less than the ranks of actual jobless, since some have exhausted their benefits.

Confronted with these constraints, several trade union experts suggested that efforts should focus more on measures designed to conserve jobs, and, as an example, they cited various provisions intended to enhance job security and hinder massive layoffs (by making them more costly to employers and/or subjecting them to authorisation). But BIAC experts warned CEECs that such measures could make the labour market more rigid, which would ultimately aggravate unemployment; in this regard, they also stressed that employment policies ought to encourage worker redeployment and enterprise creation rather than prop up outdated, uncompetitive industries.

ii. Limited financing makes it especially important that active employment policies be efficient: most resources are earmarked for training, and it was suggested that training policies should be targeted on the basis of clearly identified needs, and particularly the skills required by the sectors where the jobs are. Regional policies pose especially tough problems, since highly uneven unemployment patterns call for custom-tailored solutions. In some declining mono-industrial regions (e.g. those dominated by mining and heavy industries), as much as 40 per cent of the labour force is out of work, yet it is in those same areas that redeployment may take the longest and cost the most money, due to a lack of entrepreneurial ability and adequate infrastructure. Limited finances also create an allocation dilemma by imposing strategic tradeoffs between salvaging troubled areas and backing the most dynamic regional economies.

iii. The discussions brought out the importance, but also the limitations, of the role of small and medium-sized enterprises in resolving employment problems. BIAC representatives felt that a network of privately owned and economically viable SMEs would be the chief source of job creation -- a view that a number of speakers went on to qualify. In the Czech Republic for instance, while such newly created jobs seem to have staved off massive unemployment until now, one of that country's experts believed that the second wave of mass privatisation would lead to greater joblessness. Furthermore, the examples of Slovakia and the most economically ravaged regions have shown that jobs created in services and/or SMEs fail to meet the needs arising from major industrial restructuring. Furthermore, as some experts pointed out, SMEs are frequently offshoots of existing enterprises and do not generate any net new employment; the same can be said of enterprises resulting from privatisation. Moreover, as the private sector emerges, its tendency to evade social and tax legislation may well make jobs increasingly insecure and at the same time aggravate the fiscal shortfall that is already limiting the means of promoting employment.

iv. On this point, the participants agreed that to finance restructuring there was a need for a viable tax system that could keep government debt within reasonable limits and support public services.

v. Generally speaking, the experts emphasised the decisive impact of the overall environment on the policies of domestic and foreign investors and thus on job creation. They suggested the importance of several factors: political and social stability, which, according to TUAC experts, can be enhanced by a
three-pronged approach to problems; stable and coherent macroeconomic policies (e.g. interest and exchange rates), for informed investment decisions; a solid legal framework and a transparent environment; and appropriate infrastructure and social institutions (e.g. for training, education, health care).

Similarly, there was convergent support for a strategy of gradually and evenly raising purchasing power across the board, so as to rekindle internal consumption and create thriving domestic markets which enterprises could use to become more competitive. Several experts pointed out that without a policy to boost worker pay, the productivity gaps between the CEECs and Western Europe might be narrowed much more quickly than the corresponding wage gaps. This would heighten East-West competition in Europe and might, as a number of experts pointed out, lead to greater protectionism and social unrest. It was mentioned, however, that wage hikes should be cautious and should also take account of the fact that even within the PIT countries, productivity varies widely.

V. THE ROLE OF CO-OPERATION WITH WESTERN COUNTRIES IN RESPECT OF STRUCTURAL POLICIES

i. This topic was begun by comparing today’s policies to aid PIT countries with the Marshall Plan; the discussions were introduced by the OECD Secretariat and highlighted how the respective contexts -- and thus the priorities -- of the aid strategies differed, as did their magnitude.

The backdrop for the Marshall Plan was a world with neither cross-border flows of private capital nor international financial institutions, and one in which there was but a single source of funds -- the United States. Furthermore, the economic problems of the transition in Central and Eastern Europe differ from those of rebuilding post-war Western European economies. For example, CEECs are plagued with structural excess production capacity and distortions that did not exist in the Europe of 1945. Moreover, transition implies a change of economic systems, and the conversion is taking place in a context in which market mechanisms do not work, the financial sector is non-existent, and the institutional and legal frameworks have yet to be built. Under the circumstances, aid programmes have opted to focus first on macroeconomic stabilisation, the liberalisation and creation of market mechanisms and then on sectoral policies.

Trade union experts pointed out that U.S. policy under the Marshall Plan had been as generous for Europe as it was effective for the United States’ own economic recovery, and that this contrasted with the policy of aid to the PIT countries, whose main observable impact so far has been economic and social destabilization. While this criticism of current aid was not echoed by other participants, the ensuing discussion suggested that there was probably a fairly broad consensus that the aid was indeed less generous, and inadequate to meet the challenges and problems of the economic and political transition underway in Central and Eastern Europe.

ii. As a result, the contents of aid programmes should be spelled out and their means of implementation improved. As a rule, the experts emphasised that it was crucial to pin-point needs precisely, in order to determine the ways and means of co-operation, especially since the PIT countries are experiencing rapid change and have divergent needs. Today’s top priorities are to facilitate microeconomic restructuring and create a favourable climate for
investment, by: underwriting regional policies, to keep hopeless situations from persisting indefinitely; developing infrastructure and telecommunications; subsidising training and reskilling and transfers of modern techniques of management and administration (e.g. tax systems).

In addition, direct investment and market access will be vital to restructuring and must therefore be part of the overall design of aid to transition.

iii. One of the keys to effective aid is to improve co-operation, and particularly horizontal co-ordination. On this point, several experts suggested that the OECD should draw upon the experience of the European Productivity Agency, which was set up in 1953 as part of the OEEC. The Agency played an important role in transferring technologies and know-how to Europe: backed up by each country’s National Productivity Centre, it was at the heart of decentralised technical assistance programmes. Today the OECD Secretariat is preparing to take similar action.
### ANNEX

#### LIST OF PARTICIPANTS

**Management Experts**

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<tr>
<td>FREY, Hans-Paul</td>
<td>Director General</td>
<td>GERMANY</td>
</tr>
<tr>
<td></td>
<td>Employers Association of the Chemical Industry of Baden/Württemberg</td>
<td></td>
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<tr>
<td>DEEKS, William</td>
<td>Chairman of BIAC</td>
<td>CANADA</td>
</tr>
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<td></td>
<td>Global Business Advisor</td>
<td></td>
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<td></td>
<td>Noranda Inc.</td>
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<tr>
<td>PÉREZ GARCIA, José</td>
<td>Director General of ASS/MELC</td>
<td>SPAIN</td>
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<td></td>
<td>Committee of Industrial Politics</td>
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<td></td>
<td>Spanish Confederation of Employers</td>
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<tr>
<td>HANISCH, Ms. Melinda</td>
<td>Manager</td>
<td>UNITED STATES</td>
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<td>East-West Activities</td>
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<td></td>
<td>US Council for International Business</td>
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<tr>
<td>KEREKES, Peter</td>
<td>Partner</td>
<td>HUNGARY</td>
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<td></td>
<td>Hill International</td>
<td></td>
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<tr>
<td>KOTELNICKI, Piotr</td>
<td>Director General</td>
<td>POLAND</td>
</tr>
<tr>
<td></td>
<td>Management Resource Center - ICL</td>
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</tr>
<tr>
<td>MYRDAL, Hans-Göran</td>
<td>Director</td>
<td>SWEDEN</td>
</tr>
<tr>
<td></td>
<td>Swedish Employers’ Confederation</td>
<td></td>
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<tr>
<td>BOUCHAL, Milan</td>
<td>Adviser to the Vice-Chairman and Deputy Chief Executive</td>
<td>CZECH, REPUBLIC</td>
</tr>
<tr>
<td>ZAHALKOVA, Ms. Jana</td>
<td>Assistant to the Chairman</td>
<td>&quot;</td>
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<td></td>
<td>Komerčni Banka</td>
<td>&quot;</td>
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<tr>
<td>SARIASLAN, Halil</td>
<td>Advisor to the President</td>
<td>TURKEY</td>
</tr>
<tr>
<td></td>
<td>Union of Chambers of Commerce, Industry, Maritime Commerce and Commodity Exchanges of Turkey</td>
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**Business and Industry Advisory Committee to the OECD (BIAC)**

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<tr>
<td>BATE, Steven</td>
<td>Director</td>
</tr>
<tr>
<td>FRISVOLD, Paal</td>
<td>Manager</td>
</tr>
</tbody>
</table>
Trade Union Experts

POESE
Thomas
International Department
German Confederation of Trade Unions (DGB)

NOEL
Bernard
Secrétaire national
Centrale Générale des Syndicats
Libéraux de Belgique (CGSLB)

LEMKE
Georg
International Adviser
Danish Confederation of Trade Unions (LO-Denmark)

BARTON
Paul
Representative
American Federation of Labor & Congress of Industrial Organizations (AFL-CIO European Office)

EVANS
Jerry
Employment and Training Specialist
Human Resources Development Institute, AFL-CIO

ZELLHOEFEER
Jerry
Representative
American Federation of Labor and Congress of Industrial Organizations (AFL-CIO European Office)

JUSSAC
Christophe
Secrétaire confédéral
Secteur international
Confédération Française des Travailleurs Chrétiens (CFTC)

BATUT
Mrs. Laure
Département international
Force Ouvrière (FO)

FAZEKAS
Karoly
Deputy Director, LIGA
c/o Institute of Economics
Hungarian Academy of Sciences

GYÖRGY
Karoly
Head of the International Department
National Confederation of Hungarian Trade Unions (MSZOSZ)

SCAIOLA
Silvano
Expert
Département de la Politique Industrielle
Confédération Italienne des Syndicats des Travailleurs (CISL)

CASTORE
Giorgio
Expert
Union Italienne du Travail (UIL)

NAKAGAWA
Koichi
Director of Social Policy Planning
Office, Japanese Trade Union Confederation (RENGO)

IKUSAWA
Ms. Chihiro
Chief of International
Policy Planning Office (RENGO)
KOBASHI
Ima
Chief Research Analyst of RIALS
(RENGO Research Institute for Advancement of Living Standards)

STEVKO
Vaclav
Vice-Président des Syndicats de la République Slovaque (KOZ SR)

KARLSSON
Gösta
Economist Swedish Confederation of Professional Employees (TCO)

MOREAU
Jan-Erik
Secretary Swedish Confederation of Trade Unions (LO-Sweden)

FISERA
Ivan
Conseiller Chambre Tchéco-Morave des Syndicats (CMK OS)

ASHWIN
Ms. Sarah
Research Officer International Confederation of Free Trade Unions (ICFTU)

DUTU
Achille
Secretary World Confederation of Labour (WCL)

LANGEWIESCHE
Mrs. Renate
Assistant International Department European Trade Union Confederation (ETUC)

AINTILA
Heikki
Research Officer European Trade Union Institute (ETUI)

GAUDIN
Pierre
International Federation of Chemical, Energy and General Workers’ Unions (ICEF) Training Programmes Fédération Gaz Electricité CFDT

ROLAND
Damien
Assistant auprès du Secrétaire général Fédération Internationale des Mineurs (FIM)

Trade Union Advisory Committee to the OECD (TUAC)

EVANS
John
General Secretary

BOTSCH
Andreas
Assistant to the General Secretary

RAPPORTEUR

LEMOINE
Mrs. Françoise
Centre d’Etudes Prospectives et d’Informations Internationales
OECD SECRETARIAT

Directorate for Science, Technology and Industry

GASSMANN       Head of Division, Industry Division
Hanspeter       Chairman of the meeting

WIENERT-CAKIM   Principal Administrator, Industry Division
Mrs. Helgard

Directorate for Education, Employment, Labour and Social Affairs

BOERI           Principal Administrator, Social Affairs and Industrial
Tito            Relations Division

LIPPOLDT        Consultant
Douglas

Economics Department

DOHNER          Principal Administrator, Eastern European Division
Robert

Directorate for Financial, Fiscal and Enterprise Affairs

FREDERICK       Consultant
Richard

Centre for Co-operation with Economies in Transition

GOMM            Principal Administrator
Ms. Jean

External Relations Division

BYRNE NASON     Deputy Head of Division
Ms. Geraldine

MEYERSONH       Assistant
Mrs. Janine